(24)

In the Supreme Court of the United States

OCTOBER TERM, 1944.

No. 700

CAROLA HUNTER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ROBERT HUNTER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI

To the United States Circuit Court of Appeals
For the Sixth Circuit and

BRIEF IN SUPPORT OF PETITION.

C. J. Hoyt,
Mahoning Bank Bldg.,
Youngstown, Ohio,
Attorney for Petitioners.

G. F. Hammond,
Of Counsel.

The Gates Legal Publishing Co., Cleveland, Ohio—Main 5647

SUBJECT INDEX.

TABLE OF AUTHORITIES.

Cases.

Other Authorities.

Statutes.

In the Supreme Court of the United States

OCTOBER TERM, 1944.

No. . . . . .

CAROLA HUNTER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ROBERT HUNTER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
For the Sixth Circuit.

To the Honorable Harlan F. Stone, Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The undersigned, on behalf of Carola Hunter and Robert Hunter, petitioners, prays that a writ of certiorari may issue to review the judgment of the Circuit Court of Appeals for the Sixth Circuit, entered October 18, 1944, in the consolidated cases between the above named parties docketed therein as Number 9763, affirming the judgment of the Tax Court of the United States, wherein the parties stood in the same relation as in the above caption.

STATEMENT OF MATTER INVOLVED.

These cases involved deficiencies in individual income taxes redetermined by the Tax Court in the separate returns of the taxpayers in the aggregate sum of $2758.39, for the taxable year 1940. (R. 83.)

The petitioners purchased a farm of about 137 acres on July 1, 1940, and operated it as partners. (R. 75.) Thereafter, from time to time, and not according to any plan, throughout the rest of the year, the farm was reconditioned in several respects. (R. 59, 61.) These expenditures were made for dynamite fuses and caps for blowing out stumps and rocks, lumber, nails and labor for repairing broken boards in out-buildings, paint, brushes and labor in painting exterior of buildings, paper and paint for interior of house, replacement of broken downspouting and gutters, and returning a creek which ran through the farm to its former bed. (R. 76.) The cost of all this was deducted by the taxpayers in their individual returns as an ordinary and necessary expense incurred during the taxable year in carrying on the business of farming.

All these items were disallowed by the Tax Court which, upon appeal, was affirmed by the Circuit Court.

There was no disagreement as to the facts, the petitioner, Robert Hunter, being the only witness.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered October 18, 1944.

The jurisdiction of this Court is invoked under § 240 (a) of the Judicial Code, as amended, U. S. C. Tit. 28, § 347.

QUESTIONS PRESENTED.

1. Were the taxpayers' expenditures above set forth ordinary and business expenses under the provisions of § 23(a) of the Revenue Act?

2. Is the determination of the Tax Court that these expenditures are not deductible and are capital additions, conclusive upon the Circuit Court under the decision in *Dobson v. Commissioner,* 320 U. S. 489?

REASONS RELIED UPON FOR ALLOWANCE OF WRIT.

1. The decision of the Circuit Court of Appeals is in conflict with the decisions of other Circuit Courts of Appeals and the Tax Court, on the same matter, all of said items above mentioned having been held properly deductible as repairs in previous decisions of other Circuit Courts and the Tax Court.

2. The Circuit Court of Appeals has misapplied *Dobson v. Commissioner,* in holding that there was substantial evidence to support the findings of fact and decisions of the Tax Court, where the facts were undisputed.

3. The Circuit Court of Appeals has so far departed from the accepted and usual course of judicial proceedings, and has so far sanctioned such a departure by the Tax Court as to call for an exercise of this Court's power of supervision.

4. The Circuit Court has decided an important question relating to the income tax law, which has not been, but should be, settled by this Court.

PRAYER.

WHEREFORE, your petitioners pray that a writ of certiorari issue under the seal of this Court, directed to the Circuit Court of Appeals of the Sixth Circuit, commanding said court to certify and send to this Court a full and complete transcript of the record and of the proceedings of the said Circuit Court of Appeals had in the case numbered and entitled on its docket No. 9763, *Carola Hunter, Petitioner, vs. Commissioner of Internal Revenue, Respondent,* and *Robert E. Hunter, Petitioner, vs. Commissioner of Internal Revenue, Respondent,* (consolidated

actions), to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States, and that the judgment herein of said Circuit Court of Appeals be reversed by the court, and for such other and further relief as to this Court may seem proper.

CAROLA HUNTER,
ROBERT HUNTER,
BY C. J. HOYT,
Counsel for Petitioners.

G. F. HAMMOND,
Of Counsel.

Dated November 20th, 1944.

In the Supreme Court of the United States

OCTOBER TERM, 1944.

No. . . . . .

CAROLA HUNTER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ROBERT HUNTER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS OF THE COURTS BELOW.

The memorandum opinion of the Tax Court (R. 75, R. 78) was not published. The Circuit Court of Appeals rendered no opinion, but entered an order only which is in the record. (R. 104.)

JURISDICTION.

This has already been stated in the preceding petition at page 2, which is hereby adopted and made a part of this brief.

STATEMENT OF THE CASE.

This has already been stated in the preceding petition at page 2, which is hereby adopted and made a part of this brief.

SPECIFICATIONS OF ERRORS.

The Circuit Court of Appeals erred:

1. In affirming the judgment of the Tax Court.

2. In holding that taxpayers' expenditures, as set forth in the petition, were not deductible as ordinary and business expenditures under the provisions of § 23(a) of the Revenue Act.

3. In holding that the determination of the Tax Court that said expenditures are not deductible and are capital additions, is conclusive upon the Circuit Court under the decision in *Dobson v. Commissioner*, 320 U. S. 489.

ARGUMENT.

Summary of the Argument.

I.

The taxpayers' expenditures were ordinary and necessary expenditures paid in carrying on taxpayers' business, and were deductible under § 23(a) of the Revenue Act.

II.

The decision of the Tax Court in a case where the facts are undisputed, is a determination of a matter of law, and is not a finding of fact which is binding upon any court.

I.

The taxpayers' expenditures were ordinary and necessary expenses paid in carrying on taxpayers' business, and were deductible under § 23(a) of the Revenue Act.

All of the items heretofore enumerated in the statement of the matter involved (page 2), were expenditures for deductible repairs and were not non-deductible capital additions.*

---

* On appeal in the Circuit Court, petitioners withdrew their claim as to certain expenditures: Cost of concrete floor, $518.56; material used in reconditioning main barn, $153.14; digging trenches and drain tile, $337.90; sewer tile $17.93.

The Internal Revenue Code, page 14, provides for a deduction from gross income of all ordinary and necessary expenses paid in carrying on any trade or business. The unquestioned testimony is that these expenditures were made by the taxpayers from time to time after they acquired the farm, and as the necessity for each arose.

At the time the taxpayers purchased the property it was understood that the person from whom the farm was purchased would continue to live on the farm and operate it for the taxpayers. About two months later this man left, and the person who replaced him would not live in the house until it had been renovated. (R. 64.) Hence, the necessity arose for the expenditure of money for painting and papering the interior of the farmhouse.

About six weeks after the taxpayer purchased the property there was a heavy rain storm which caused the creek on the farm to flood the barnyard. When the taxpayer observed this he decided to return the creek to its former bed, which was located farther from the barnyard so that it would not cause damage when a heavy rain took place. (R. 65, 66.)

Neither of these expenditures were contemplated by the taxpayer when he purchased the farm, and could not possibly have been part of a plan to improve and recondition the farm because of the very sequence of uncontrolled events. These items were disallowed by the Tax Court as were all the other items on the ground that the expenditures were "for the purpose of improving and reconditioning the farm, not as an incident of current operation—an ordinary and necessary expense of carrying on business—but of putting it in shape for permanent or indefinite operation." (R. 77.)

This decision is contrary to *Illinois Merchants Trust Company v. Maniere*, 4 B. T. A. 103.

Furthermore, this land had been operated as a farm for many years, and had been so operated with the stumps,

rocks and creek in the condition they were when petitioners purchased it. The expenditures made in those respects in no way increased the value of the land. Hence the statement of the Tax Court (R. 77) that the cost of these items could be recovered through sale is wrong, as a matter of law. Likewise, as to the Tax Court's statement that they could be depreciated throughout the life of the investment. It is unnecessary to cite authorities for the proposition that land cannot be depreciated.

The Tax Court relied upon the case of *I. M. Cowell*, 18 B. T. A. 997, as authority for its holding. That case was decided by the same Judge who decided the instant case in the Tax Court. It is worthy of note that there were three dissents in the *Cowell* case, on the ground that repairs which neither materially add to the value of the property or appreciably prolong its life, but only keep it in an ordinarily efficient operating condition, may be deducted as an expense. Certainly the removal of the rocks and stumps and the change of the creek bed did not prolong the life of this property. The creek will always be there, and its bed will have to be re-excavated as frequently as it overflows and forms a new bed. This will be a recurring expense.

In using the dynamite to blast out the rocks and stumps, an overcharge of dynamite was used, and windows in petitioners' buildings and also windows in neighboring houses owned by others, including a church, were broken by the explosion. Petitioners paid for these damages, and the Tax Court disallowed it. How that could come under the theory of the Tax Court's opinion, it is impossible to understand. Certainly the damage item did not add to the value of petitioners' property, and it could not be recovered either through sale or depreciation. This is contrary to *Parkersburg Iron & Steel Company v. Burnet*, 48 F. (2d) 163 (C. C. A. 4). It is also contrary to *Marble & Shattuck Chair Company v. Commissioner*, 39 F.

(2d) 393 (C. C. A. 6), where beams and floor boards were subject to dry rot due to inadequate ventilation. The taxpayer installed a ventilator, and in doing so damaged the roof. The replacement and repair of the roof were held deductible.

Replacing broken boards in the various outbuildings is a deductible expense under the decision in *Rose, Collector of Internal Revenue v. Haverty Furniture Co.*, 15 F. (2d) 345 (C. C. A. 5), where many items identical with those here in question were allowed as deductible expenses. See also the following cases:

Treat Hardware Corporation v. Commissioner of Internal Revenue, 6 B. T. A. 768;

Grand Rapids Railroad Company v. Doyle, 245 F. 792;

Squier v. Commissioner, 13 B. T. A. 1223;

E. J. McMillan, B. T. A. Memo. Opinion, Docket 97724;

E. L. Potter, 20 B. T. A., 252;

Louise Kingsley, 11 B. T. A. 296.

Electric wiring had to be replaced because the existing wiring did not pass inspection. This was properly allowable under *John A. Schmid*, 10 B. T. A. 1152.

The items for painting the exterior of the various buildings are properly deductible under the following cases:

E. L. Potter, 20 B. T. A. 252;

Max Kurtz, 8 B. T. A. 679;

Treat Hardware Corporation, 6 B. T. A. 768.

Numerous cases sustaining all the above deductions are found in 4 *Mertens, Law of Federal Income Taxation*, § 25.32.

It is unreasonable to hold that an ordinary outside paint job which has to be repeated every few years, is a

capital investment. The same is true as to the items for replacing the gutters, downspouts and broken slate in the roofs. It is inconsistent for the Board of Tax Appeals to allow $4.29 to replace broken windows in petitioners' property, and not allow deduction for like damage caused to neighboring property because of the explosion.

The Board of Tax Appeals allowed $4.12 for whitewashing, but refused to allow anything for exterior or interior painting. Interior whitewashing will last as long as exterior painting.

There is no consistency in the holdings of the Tax Court, and they are completely out of line with all authorities cited above. The affirmance by the Circuit Court of Appeals is contrary to its own holdings in like cases, and the holdings of other circuits as shown by the cases cited.

This is not an instance where the property was being reconditioned to adapt it to another use which is the distinguishing element in some cases. Neither was it a complete reconditioning for taxpayers' own use. There is not any evidence, nor can the inference be made, that there was a plan of reconditioning in taxpayer's mind when he purchased this property. The only evidence is to the contrary as the taxpayer testified the expenditures were made from time to time as the situation arose, and this is fully corroborated by the fact that the interior of the building was not papered and painted until a new farmer was to take charge, and the creek bed was not changed until taxpayer had seen the effect of a severe storm.

Neither is it decisive that an expense may have to be incurred but once (although we claim that all the expense here would have to be incurred periodically), many expenses which occur but once are allowable deductions, such as the replacement of broken parts.

The argument was made that because the taxpayer was in the construction business that he had a general plan of improvement in mind when he bought the property. That

is not even a reasonable inference from the record as the taxpayer's construction business was not concerned with the kind of expenses that were here incurred. The taxpayer did none of the work himself, or through his construction company, and the record shows that every item of expense was incurred through contracts with other persons.

II.

The decision of the Tax Court in a case where the facts are undisputed, is a determination of a matter of law, and is not a finding of fact which is binding upon any court.

Upon argument of this case in the Circuit Court, the judges questioned each item discussed by the writer, and stated that each was a fact determined by the Tax Court under the rule in the *Dobson* case. Counsel for respondent took his cue from the statements of the court, and that was his sole argument. Unfortunately, the Circuit Court rendered no opinion, but in its judgment entry stated that there was substantial evidence to support the findings of facts and decisions of the Tax Court. (R. 104.) The judgment, therefore, is the result of the Circuit Court applying the rule in the *Dobson* case.

This Court, speaking of the Tax Court in the *Dobson* case, said:

> "Its decision, of course, must have 'warrant in the record' and a reasonable basis in the law."

Its decision here has neither. There is no disputed question of fact in the case, hence the decision of the Tax Court is purely a determination of a question at law. That is the rule that has been universally applied. It has been applied so fully as to require the discharge of a jury, when there are no controverted facts as there is no function for a jury to perform when there is no dispute concerning the facts. The court applies the law to the ad-

mitted facts. Under the rule in the *Dobson* case the decision of the Tax Court must have a reasonable basis in the law. Here the decision of the Tax Court had no warrant in the record and no reasonable basis in the law, and the Circuit Court affirmed the Tax Court.

The expenditures have admittedly been made, hence the only question is the legal effect of those expenditures—the application of the law to the facts. This is purely a question of law.

Even since the *Dobson* decision this Circuit Court has not felt itself foreclosed from examining the record, as it has said in syllabus one, to *Thal v. Commissioner*, 142 F. (2d) 874:

> "Circuit Court of Appeals in reviewing Tax Court's decision will not weigh the evidence or reasonable inferences to be drawn therefrom but may search the record to determine whether there is any substantial evidence to support Tax Court's findings of fact."

However, the Circuit Court failed to do either here, apparently feeling itself bound by the *Dobson* case, and that the determination of the Tax Court that an expenditure is a capital investment instead of a deductible expense, is a determination of a question of fact. We emphatically assert that such a determination is a question of law solely, when, as here, the facts are undisputed.

The determination of this case by the Circuit Court on the ground that there was substantial evidence to support the findings of fact, is a clear determination on the principles enunciated in the *Dobson* case. There were no facts to be found. They were admitted by the taxpayer, the only witness in the case. The denomination of the application of law to the facts as a finding of fact as decided the *Dobson* case, is without precedent except in the *Dobson* case. It is said in 57 *Harvard Law Review*, 754:

> "Closer analysis, however, discloses that the opinion moves far beyond traditional principles of review in

> treating as fact what is *commonly regarded as law*, and in suggesting that administrative finality attaches, to some unknown extent, to conclusions of law as well as findings of facts." (Italics ours.)

The above quotation is from a thoughtful and critical consideration of the *Dobson* case by Randolph E. Paul. The criticism of the *Dobson* case is so constructive, and the implications arising therefrom so clearly enunciated, that we respectfully suggest that this Court should carefully re-examine the principle of the *Dobson* decision in order that there may be no future confusion in the application of the rule by the Circuit Courts, and that Appellate Courts should not be required to construe a determination of a pure question of law as a determination of a question of fact which now seems to be required under the *Dobson* decision.

It is therefore respectfully submitted that a writ of certiorari should be granted and full review be had by this Court and the decisions below be reversed.

C. J. Hoyt,

Attorney for Petitioners.

G. F. Hammond,

Of Counsel.

APPENDIX.

Internal Revenue Code:

SEC. 23 [as amended by the Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 121 (a)]. DEDUCTIONS FROM GROSS INCOME.

(a) *Expenses.*—(1) *Trade or business expenses.*—

(a) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business,

* * * * *

(26 U. S. C. 1940 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General rule.*—In computing net income no deduction shall in any case be allowed in respect of—

* * * * *

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

(3) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made;

* * * * *

(26 U. S. C. 1940 ed., Sec. 24.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (a)—1. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, * * *. Among the items included in business expenses are management expenses, * * *, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see section 19.23 (a)-2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other

similar losses in the case of a business, and rental for the use of business property. * * *

SEC. 19.23 (a)-4. Repairs.—The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided the plant or property account is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, should be charged against the depreciation reserve if such account is kept. * * *

INDEX

CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 700

CAROLA HUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ROBERT HUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 75–78) is not reported. The Circuit Court of Appeals did not render an opinion.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on October 18, 1944 (R. 104). The petition for a writ of certiorari was filed on No-

vember 24, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the court below erred in affirming the decision of the Tax Court which held that certain expenditures made by taxpayers were not ordinary and necessary expenses incurred in carrying on a trade or business within the meaning of Section 23 (a) of the Internal Revenue Code, but on the contrary constituted non-deductible expenditures under Section 24 (a) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

The statutory and regulatory provisions involved are set forth in the Appendix, *infra*, pp. 7–10.

STATEMENT

The facts found by the Tax Court (R. 75–77) may be summarized as follows:

The taxpayers, as partners, purchased a farm of 137 acres on July 1, 1940. The farmhouse, being over 155 years old, was in bad condition and a tenant refused to move in until the place was thoroughly renovated. Accordingly, walls were removed and others added in order to enlarge the second floor. The farmhouse was painted and redecorated. Gutters, downspouts, and roof slates were replaced. (R. 75.)

A creek which ran through the farm had formed an elbow extending toward the barnyard. This threatened soil erosion and serious damage. To prevent further damage, the elbow was removed by restoring the original bed of the creek. (R. 76.) Also, to enlarge the fields, stumps and rocks were removed by blasting. In so doing, taxpayers incurred expenses for dynamite, caps and fuses. In the course of the blasting, some damage resulted, consisting mostly of broken windows and sash; the taxpayers caused the damage to be repaired. (R. 75.)

The chicken coop, pigpen, sheep shed and dairy barn were all in need of renovation. Rotted and decayed boards were removed from these buildings and replaced with new lumber. The buildings were also painted. An electrical installation was in existence but it had never been inspected and was reconditioned to meet the approval of the county inspectors. (R. 75.)

The Commissioner ruled that the expenses in connection with above matters were not deductible and determined deficiencies in income tax against taxpayers (R. 5, 13). The Tax Court agreed with the Commissioner's ruling (R. 75–78). The cases were consolidated on appeal (R. 90) and the Circuit Court of Appeals affirmed the decision of the Tax Court (R. 104).

ARGUMENT

Whether the expenditures incurred by taxpayers were deductible as ordinary and necessary business expenses constituted a question of fact for the determination of the Tax Court. *Commissioner* v. *Heininger,* 320 U. S. 467; *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231. While the evidence consisted almost entirely of the testimony of one witness, that does not, as claimed (Pet. 11–12), transform factual determinations into legal conclusions. Whether the expenditures were for permanent improvements or betterments which increased the value of the property, as the Tax Court found, or whether they were for repairs of a recurring type which did not prolong the life or add to the value of the property, were factual inferences to be determined by the Tax Court from the evidence. *Commissioner* v. *Scottish American Investment Co.,* Nos. 52–54, 220–222, present Term, decided December 4, 1944. The conclusions of the Tax Court, being reasonably based on the evidence, were properly affirmed by the court below.

The expenditures here were the kind which Section 24 (a) of the Internal Revenue Code (Appendix, *infra,* p. 7) describes as not being deductible. Increasing the productivity of taxpayers' farm by changing the course of a creek to prevent further soil damage and erosion, and enlarging the tillable acreage by removing stumps

and rocks were matters which increased the value of the taxpayers' property; the cost of accomplishing this was properly held not to be deductible but subject to recoupment on a sale of the property.[1] Although taxpayers assert that this did not increase the value of the land (Pet. 8), it is difficult to understand how farm land which is made more productive can fail to be more valuable. But if that matter could properly be disputed, it is submitted that the very kind of factual question is presented by the record which the taxpayers deny exists (Pet. 11–12).

Expenditures to recondition the chicken coop, pigpen and sheep shed by replacing decayed boards with new lumber; the cost of renovating the farmhouse by removing and adding walls in order to enlarge the second floor, by painting and decorating, and by replacing the gutter, down-spouts and roof slates; payments for reconditioning the electrical installations—these were all outlays which the Tax Court justifiably held not to constitute ordinary business expenses. Since these expenditures resulted in an increase in the useful life or value of the property being improved, they were not deductible under Section 24 (a) of the In-

[1] Although it is asserted (Pet. 8) that the Tax Court erroneously stated that the increased value of the land should be depreciated, the Tax Court actually stated that all the expenditures involved in this case "are added to the cost of the investment, to be recovered either through sale or depreciation throughout the life of the investment" (R. 77).

ternal Revenue Code and under the applicable provisions of Treasury Regulations 103 (Appendix, *infra,* pp. 7–9).

The cases cited by taxpayers do not reveal that any errors of law were committed by the Tax Court. On the contrary, they demonstrate that each case must be decided on its own facts and that determinations of the triers of fact, supported by substantial evidence, must be accorded finality. See *McDonald* v. *Commissioner,* No. 36, present Term, decided November 20, 1944.

CONCLUSION

The decision of the Circuit Court of Appeals is correct. There is no conflict of decisions, and no question of importance is presented. Accordingly, the petition for a writ of certiorari should be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
ROBERT N. ANDERSON,
HILBERT P. ZARKY,
Special Assistants to the Attorney General.

DECEMBER 1944.

APPENDIX

Internal Revenue Code:

SEC. 23 [as amended by the Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 121 (a)].

DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

* * * * *

(26 U. S. C. Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

* * * * *

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

(3) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made;

* * * * *

(26 U. S. C. Sec. 24.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23(a)-1. *Business expenses.*—Business expenses deductible from gross in-

come include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, * * *. Among the items included in business expenses are management expenses, * * *, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see section 19.23(a)–2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. * * *

SEC. 19.23(a)–4. *Repairs.*—The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided the plant or property account is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, should be charged against the depreciation reserve if such account is kept. * * *

SEC. 19.23 (a)–11. *Expenses of farmers.*—A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming. The cost of ordinary tools of short life or small cost, such as hand tools, including shovels, rakes, etc., may be deducted. * * * The cost of farm machinery, equipment, and farm buildings represents a capital investment and is not

an allowable deduction as an item of expense. Amounts expended in the development of farms, orchards, and ranches prior to the time when the productive state is reached may be regarded as investments of capital. Amounts expended in purchasing work, breeding, or dairy animals are regarded as investments of capital, and may be depreciated unless such animals are included in an inventory in accordance with section 19.22 (a)–7. The purchase price of an automobile, even when wholly used in carrying on farming operations, is not deductible, but is regarded as an investment of capital. The cost of gasoline, repairs, and upkeep of an automobile if used wholly in the business of farming is deductible as an expense; * * *.

SEC. 19.24–2. *Capital expenditures.*—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. * * *

SEC. 19.41–3. *Methods of accounting.*—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. (See section 54 and section 19.54–1.) Among the essentials are the following:

* * * * *

(2) Expenditures made during the year should be properly classified as between

capital and expense; that is to say, expenditures for items of plant, equipment, etc., which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account; and

(3) In any case in which the cost of capital assets is being recovered through deductions for wear and tear, depletion, or obsolescence, any expenditure (other than ordinary repairs) made to restore the property or prolong its useful life should be added to the property account or charged against the appropriate reserve and not to current expenses.

U. S. GOVERNMENT PRINTING OFFICE: 1944